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DOCKET FILE COPY ORIGINAL

November 15, 1993

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: *RM-8356 / Reform of the Interstate Access Charge Rules*

On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six copies of their "*Reply Comments*" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

JoAnn Goddard/JCN

Enclosures

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Reform of the Interstate Access Charge Rules	)	RM-8356
	)	

REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL

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SUMMARY

The Commission should conduct the rulemaking that USTA proposes as soon as possible, but in any event before it proposes new price cap rules. The Commission should gather evidence of supply and demand elasticities in the markets where we face competition. Without such evidence meaningful rulemaking will not be possible.

Most of the parties opposing USTA's petition contend that no substantial competition has emerged for access services, or that with pricing flexibility the LECs may be expected to behave anticompetitively. The evidence points the other way. We have already lost a substantial part of the special access market to competition. The rules under which we operate are lagging farther and farther behind the marketplace. Expanded interconnection, the authorization of intraLATA competition, and huge expansions in the capital resources that are available to our competitors, are all converging at once. Reform cannot await the loss of our markets.

The Commission should proceed with this rulemaking with two principles in mind. First, it must make a meaningful inquiry into the respective market power of ourselves and our competitors. As the Commission recognized in Docket 90-132, market power cannot be determined without considering demand and supply elasticities. The demand and supply elasticities for the access service market are very high. Second, it should weigh the proven benefits of competition against the highly implausible

allegations that have been made so casually about our ability to predatorily price or to cross-subsidize competitive services with revenues from noncompetitive ones. An examination of the access market would almost certainly show that it is not susceptible to predatory pricing. And the only anticompetitive cross-subsidies that we know of result from requirements that we subsidize services and geographic areas with low demand elasticities with revenues from services and geographic areas that are vulnerable to competition. This hurts us, not our competitors.

USTA's proposal is if anything too cautious. It is, nonetheless, a place to start. The Commission should conduct a rulemaking immediately.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Reform of the Interstate Access Charge Rules	)	RM-8356
	)	
	)	

REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL

In accordance with the Commission's Public Notice of October 1, 1993, Pacific Bell and Nevada Bell hereby respectfully submit reply comments on the United States Telephone Association's (USTA's) Petition for Rulemaking on Reform of the Interstate Access Charge Rules ("Petition").

Most of the comments who oppose USTA's Petition do so either because they dispute its premise -- the emergence of substantial new competition for local exchange access services -- or because they assert it will permit the LECs to behave anticompetitively. Neither of these assertions has any merit.

The Commission should immediately require all providers of access services to file data showing their facility deployment and switched minutes of use, as it now requires us to do. Given any competition at all in the local exchange, the Commission cannot regulate us asymmetrically without the evidence it needs to determine any carrier's market power. Our competitors have put our market power in issue. They should cooperate in settling the issue.

The Commission should grant USTA's petition expeditiously. It should take evidence on at least the basket structure and pricing issues in USTA's petition no later than when it proposes rules in the upcoming rulemaking to review the LEC price cap rules. How much competition there is, and how much competition justifies pricing flexibility, can be debated in the rulemaking that USTA proposes. Those parties who contend the Commission should do no more than issue a Notice of Inquiry are stalling for time. Neither claims that the LECs have no effective competition, nor contentions that USTA's proposal would allow pricing flexibility based on insufficient criteria, is any reason not to have a rulemaking.

I. The Local Exchange Is Highly Competitive By Any Measure.

Access reform is critical for Pacific Bell and Nevada Bell because our markets are geographically more concentrated than those of other LECs. Our competitors can make great inroads into our markets with minimal investment by undercutting our geographically averaged rates in just a few wire centers. We understand that as of this date, a majority of the collocation requests nationwide have been filed in our territory, which reflects the high concentration (and vulnerability) of our markets. The orders for collocation that we have received to date are for offices that currently provide 31% of our DS3 capacity. Two cages have already been turned over to

collocators. Sixteen wire centers in our territory account for half of the hicap traffic.

Our competitors know this. Currently, competitive access providers (CAPs) are allowed to provide hicap service without any restrictions. We estimate they have captured about a quarter of the hicap market in the Los Angeles and San Francisco wire centers they serve. They are not fledglings. Teleport Communications Group has the financial resources of TCI and Bell Atlantic at its disposal. Linkatel and Phoenix Fiberlink, two other CAPs active in California, have financial backing from AT&T. And at current valuations MFS Communications Co. has a market value of about $2.5 billion.

There are at least two things to consider about the enormous value that investors have recently put on our competitors' businesses. First it gives some idea of the financial resources available to CAPs in today's equity markets. The Commission's decisions on expanded interconnection have increased the value of our competitors' operations -- their ability to raise additional capital to compete with us -- by billions of dollars. Second it shows that investors do not believe our competitors' business opportunities are nearly as limited as those competitors claim when they talk to regulators.

Once expanded interconnection is combined with intraLATA competition (a combination that is imminent in California) CAPs can combine their existing hicap networks with switches from LECs or others to provide intraLATA toll service that is fully competitive with the LECs'. MFS already does so in New York,

where MFS's Intellenet subsidiary holds itself out as a "full-service" provider of integrated local, long distance, and IN services including least-cost routing, 800 service, voice mail, and facilities management, as well as customized billing and management reports.[1]

CAPs do not need LEC switches to compete with LECs, however. TCG has installed 5ESS switches in San Francisco and Los Angeles and has been assigned a prefix with 10,000 numbers. MFS has installed ATM switches in San Francisco and Los Angeles. IXCs have had dialtone-capable switches in our LATAs all along. CAPs and other competitors can partner with and gain access to other carriers' switches, just as they are partnering with non-traditional providers like energy utilities, municipalities, and special districts.

As MFS itself said in its Comments in Docket 91-141, "MFS believes it is inevitable that non-LECs will begin providing subscriber loops and competitive local switching in some markets within the relatively near future."[2] The "relatively near future" has arrived. IXCs, CAPs, and cable television companies are natural partners. CAPs provide IXCs with access to the local exchange that is unburdened by the expense of funding universal service or providing geographically averaged service to high-cost

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[1] "MFS Rolls Out Integrated Local/Long Distance Service Package in New York," Telco Competition Report, vol. 2, No. 19 (Oct. 14, 1993).

[2] Comments of MFS Communications Company, Inc., Docket 91-141, Phase II, filed April 2, 1993.

markets. For cable television companies, whose networks are a sunk cost, the incremental cost of reconfiguring a network to provide wireline telephone service is relatively small and may be recovered from cable television customers. By joining with CAPs or with other carriers such as Bell Atlantic, cable television providers can obtain the expertise, switching, and customer credibility to provide that service. Through TCI/Bell Atlantic, TCG will have access to over 30% of the California market and 59 of the top 100 markets nationwide.

Wireless customers have been free to use other providers for some time now. It is clear that if AT&T is allowed to acquire McCaw, for example, its strategy will attempt to make cellular the access vehicle of choice for end users by incorporating AT&T network features like voice mail, CLASS features and number portability. The price of cellular access is rapidly falling and its quality is increasing. Up to now wireless/cellular and wireline service have been complementary. They are becoming cross-elastic.

AT&T's cellular service will also be the first wide-area wireless data network. AT&T/McCaw plans to equip half of its U.S. markets with Cellular Digital Packet Data technology by the end of this year, and the other half by mid-1994, meaning that users will have 9600 bits-per-second wireless packet networking in at least 105 U.S. cities. As one McCaw spokesman said, "With

our cellular phone service, we're the embodiment of one person, one number and soon that will extend to your portable computer."[3] This is an understatement. With hardware from Matsushita and Murabeni and software from GO Corp., AT&T can also provide the computer.

Examples like these abound. But snapshots of today's market are really beside the point. As the Commission recognized when it authorized expanded interconnection, "special access and switched transport competition could develop much more rapidly than interexchange competition did."[4] Events have borne this out. As we said above, competitors captured about a quarter of the hicap markets they entered in Los Angeles and San Francisco even without expanded interconnection or any other help from regulators. They are now poised for by far the most rapid growth yet as the last pieces fall into place. Expanded interconnection; the authorization of intraLATA competition by local regulators; and the recent sudden expansion in the capital resources that are available to our competitors -- all these assure that any snapshots we provide today will be out of date

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[3] Wall Street Journal, August 18, 1993, p. C1. At present, throughout its licensed areas, McCaw does not depend on LEC switches. Its users receive dialtone directly from McCaw switches, and are able to receive long distance service that is cheaper and more convenient than what the RBOC cellular affiliates can offer because McCaw is subject to no interLATA restrictions.

[4] Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, FCC 92-440, released October 19, 1992, at para. 115, n.253.

next week. Competition, while already robust, will develop far more rapidly than it did in long distance. Emerging competition demands access reform now.

II. USTA's Proposal Will Enhance Competition.

USTA's proposal is cautiously pro-competitive. It does not deregulate us. It does not allow unlimited pricing flexibility, even for services that our competitors can provide without any restrictions whatever. It does match pricing flexibility to the existence of competition in carefully defined areas.

We would like to state two principles for the Commission to consider when it proposes new access rules. First, any access reform proposal that is pro-competitive has to recognize that "market share" is not the same as "market power" and should not by itself determine where pricing flexibility is permitted. Second, the Commission should recognize as implausible allegations that with more pricing flexibility we would predatorily price or cross-subsidize and drive their competitors from the market.

The current access rules are anticompetitive. Access charges are geographically averaged over study areas that bear no relationship to economic markets. Tariffing requirements make us charge like-prices to customers with radically unlike-costs. Because prices differ from costs, the wrong signals are sent to customers and potential entrants. Customers cannot reward the

most efficient providers by purchasing their services. Potential entrants receive incorrect signals of their ability to produce services more efficiently than current providers.

We are also forced to give out information that any competitive business would treat as proprietary. We are required to provide long advance notice to customers of new service offerings, which, because they are subject to challenge by our competitors and require Part 69 waivers, we may never be allowed to provide at all. USTA's proposal allows us to respond more reasonably to customer needs. Our competitors oppose it because they want to be able to meet customer needs better than we can.

Market power is different from market share. In Docket 90-132, the Commission recognized that "market share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities."[5] IntraLATA access services is such a market. Access services are fungible and widely resold. They are purchased by sophisticated customers, all of whom have alternatives including, for most, supplying themselves. Thus, for the carrier access market, market power is largely a function of each providers' capacity, not its current revenues -- the fraction of the market that can be served by any provider.[6] USTA's proposal recognizes this. But the commenters opposing USTA's proposal do not.

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[5] Competition in the Interstate Interexchange Marketplace, 6 FCC Rcd 5880, 5890 (1991).

[6] See also U.S. Department of Justice, Merger Guidelines, April, 1992.

Therefore, while our competitors make claims about the state of the access services market, the true market power of any provider -- including us -- is unknown because we are the only ones required to file information on switched usage and the transmission capacity we have deployed. Our competitors treat information about their own networks and capacity as proprietary. This gives them a competitive edge, but more important, it makes it impossible for us to disprove their allegations that we have such overwhelming market power that we should not be allowed pricing flexibility. All common carriers should have to file the same information on fiber deployment and switched usage by location that we file.

What we do know about the market for carrier access services indicates that there is if anything an oversupply of capacity. The huge capacities of fiber and the amount of fiber that we know competitors have already installed in the local exchange make it highly unlikely that we could restrict supply enough to exercise market power. As MCI recently said -- as evidence of robust long distance competition -- "every carrier that has built fiber capacity has installed plenty of extra capacity."[7]

Elasticity of demand is also high. There is a buyers' market for access services. The vast majority of carrier access services are sold to sophisticated customers who can either

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[7] MCI News Release, October 26, 1993, "Long Distance: Public Benefits from Increased Competition," Robert E. Hall, p. 23.

supply the services themselves or who know where else to get them. AT&T's claim that "less than one percent" of IXC access expenses are paid to CAPs (AT&T Comments, p. 5; emphasis in original) is no proof of the LECs' market share or market power. It fails to differentiate between distinct, specific markets, and it ignores the access functions that are or could be part of AT&T's network. In fact it is completely inconsistent with the standard for determining market power that AT&T successfully proposed for business services in Docket 90-132. Expanded interconnection increases the reach of the IXCs' networks even further than they extend today, and increases the number of suppliers. The Commission recognized the relevance of elasticity of demand to market power in Docket 90-132.[8] Our competitors do not.

In addition to testing claims about our market power, information on fiber deployment and switched usage would also put to rest claims that pricing flexibility would allow us to predatorily price our services and drive our competitors out of business. Predatory pricing "is rarely attempted, and even more rarely succeeds."[9] Market dominance and the ability to recoup funds invested in predatory pricing are both necessary for it to succeed. Even if we had market dominance and could succeed in predatorily pricing, recoupment would likely be impossible. Our

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[8] 6 FCC Rcd at 5888.

[9] Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574 (1986).

competitors' financial resources are often equal if not superior to ours, and their businesses all extend beyond the boundaries of ours. Our competitors would survive predatory pricing to re-enter our markets at will. Their networks are a sunk cost that can be used for a multitude of services. When the predator raises its prices to recover its lost profits, the rival's network is still there, and the barrier to re-entry is very low.

These economic facts do not even address the rules the Commission has devised to preclude any hidden cross-subsidies, most of which, despite efficiency costs to consumers, will remain in place even under USTA's proposal. Today's cross-subsidies run from geographic markets and services with high demand elasticities (such as low-cost areas and switching and transport) to markets and services with low demand elasticities (such as high-cost areas and the local loop). That is anticompetitive and must be corrected. But it tilts the field toward our competitors, not us.

USTA's proposal addresses the anticompetitive effects of the current rules very cautiously. In the absence of data on the capacity and therefore market power of our competitors, it uses actual competition as the touchstone for pricing flexibility. That flexibility is granted gradually and only after a hearing. The burden of demonstrating sufficient competition exists will be on us. Price caps for initial market areas and transitional market areas assure that no cross-subsidy to fully competitive market areas is possible. Our ability to offer innovative and customer-specific services will be somewhat improved -- the

absurd requirement of obtaining a waiver every time we want to provide a customer with a new service will be removed -- but we will still be subject to requirements our competitors do not face. The claims some parties make that this is "deregulation" are overblown. Their claims that sufficient competition does not exist can be addressed not only in another pleading cycle on proposed rules, but under USTA's proposal in every market area where we ask for pricing flexibility. That is why we say if anything, USTA's proposal does not go far enough.

Some parties, such as CompTel, say the LECs have already been given too much pricing flexibility: "deaveraged rates and volume and term discounts for special access services ... zone density pricing, volume and term discounts for entrance facilities, and even volume discounts for interoffice transport, once certain minimal conditions have been met." (CompTel, p. 11.) Most of these contentions are just semantic games: CompTel describes as a "volume and term discount" anything that is not priced on the equal charge per unit of traffic principle. Zone density pricing was a genuine step forward, but a tiny step. We will not be able to lower prices for DS3 service in the highest density zone by more than 10% per year adjusted for the price cap index, without triggering the additional cost justification and advance notice requirements contained in the price cap rules. In addition, our DS1 and DS3 price movements will continue to be constrained by the 5% pricing bands around the existing DS1 and DS3 subindices and by the 5% pricing band around the Hicap service category of the special access basket.

The zone density adjustments will have to be based on computer generated results of the interactions of three layers of price bands, all unrelated and unresponsive to market conditions.

As the Commission and the courts have previously recognized, in competitive markets the relevant costs for a price floor are LRIC.[10] The rate reductions we are permitted under zone density pricing do not move our prices to anything resembling LRIC. At zero miles, Pacific Bell's DS1 prices are nearly twice as high as their statewide-average LRIC. For a circuit with 10 miles, Pacific Bell's DS1 prices are more than three times higher than their statewide-average LRIC. This pricing creates a price umbrella under which competitors can easily price, without fear of a competitive response by Pacific Bell. Consumers foot the bill.

MCI's "Building Blocks" proposal (MCI Comments, p. 2) is not even worth considering. In the absence of competition it might have some merit, but given any competition at all it cannot be justified. In effect it would offer our network to our competitors piece by piece, whether competitors need any piece to compete with us or not, and would price each piece without regard to its market value. It is the opposite of what the Commission should do to promote consumer welfare.

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[10] See Private Line Rate Structure and Volume Discount Practices, 97 FCC 2d 293, 945 (1984). See also MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1123 (7th Cir. 1983).

III. The USTA Proposal Must Be Considered Expeditiously.

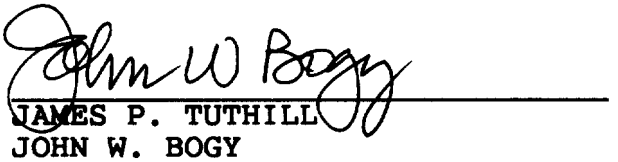
Next year the Commission will consider revisions to the LEC price cap rules. The pricing and basket structure proposals in USTA's Petition have to come first. Unless a full record on the state of the access services marketplace and the need for reform is assembled, the Commission will not even be in a position to propose new price cap rules. Any proposed price cap revisions will be premised on assumptions -- such as whether the LECs have dominance in certain markets -- that cannot be safely assumed without a full record on the USTA Petition, including data on the capacity of all providers and demand elasticities in local access markets. Once price cap rules are proposed it will be too late to test underlying assumptions like "the LECs are dominant carriers" (whatever that means). The debate will shift to the margins, and meaningful reform may be postponed for years.

IV. Conclusion.

A full rulemaking along the lines that USTA proposes should be commenced immediately. Our competitors have raised the issue of market power. In the rulemaking proceeding, the Commission should begin to resolve that issue by requiring all carriers to file data on fiber deployment and switching usage by location just as we do.

Respectfully submitted,

PACIFIC BELL
NEVADA BELL



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Date: November 15, 1993

CERTIFICATE OF SERVICE

I, D. E. Van Laak, hereby certify that copies of the foregoing "REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL", re RM-8356, were served by hand or by first-class United States mail, postage prepaid, upon the parties appearing on the attached Service List this 15th day of November, 1993.

By: 
D. E. Van Laak

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RM 8356
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